November 11, 2012

To: The members of the Commission

From: State Representative John Kowalko (Intervener in the Matter)

Subject: Response to the Findings and Recommendations of the Hearing Examiner in the matter of the application of Delmarva Power & Light Company for an increase in Electric Base Rates and Miscellaneous Tariff Changes and the Proposed Settlement Agreement.

I am urging the Commission to not approve the **Proposed Settlement Agreement** that has been brought before you in the matter of **PSC DOCKET NO. 11-528.**

Before you review the evidence that follows, I would like to point out that the Draft of the Hearing Examiner's Report was composed by the attorney assigned to the Public Advocate's Office and there appears to be a deferential attitude toward DP&L and the proposed Settlement Agreement that may have been adopted in the Hearing Examiner's final decision. There also appears to be unsubstantiated editorializing in some parts that may influence the Commissioners' interpretation of circumstances both prior to and during the Evidentiary Hearing.

For example, in the background section on page 4 (8), the Hearing Examiner refers to the 1,500 comments from customers opposing the company's proposed rate increase with a somewhat dismissive undertone, referring to them as "primarily by email from members of AARP." This reference seems to diminish the poignancy of witness Hartigan's testimony on page 17 (41), which states that "Staff had received 1,500 written public comments *unanimously opposing* the proposed rate increase," without parsing any presumed value.

The references in the footnotes on pages 37 and 38 to my assertion (Tr. at 147) that I was representing the ratepayers' interests and the Hearing Examiner's claim that the *Public Advocate* is tasked with that duty, should in no way be misconstrued as validating that the Public Advocate's Office is adequately fulfilling that duty. For example, I refer you to the fact that the party most objecting to my inquiries for detailed substantiation of costs was the attorney for the Public Advocate who also composed the draft of the Hearing Examiner's Report. Even more striking is the Hearing Examiner's position (page 38, footnote 12) that he has "observed that the Delaware Superior Court has placed significant weight on the Public Advocate's support of a settlement as being in

the public interest since that entity is charged with protecting Delaware's ratepayers" is a naïve presumption that the entity is complying with the enabling legislation in this case.

In addition, taking Staff witness Gannon's testimony, on page 42 (90), that "depreciation on utility plant is a normal utility cost" as evidence or support for the conclusion that ratepayers must bear that cost, as opposed to the company's shareholders, is another aspect of the Report that is not borne out by evidence.

The Hearing Examiner's statement, on page 37 (82), that the "Settling Parties represent diverse interests" belies the reality that one of those parties confidently recognized is DEUG, which has promoted and agreed to a Settlement that places absolutely no financial burden on them, as seen on page 22 (49).

Further, the attitude that permeates the Hearing Examiner's report seems to be that approval of displacement or addition of equipment by the PSC and allowing a "regulatory asset" to be calculated is a tacit approval of that asset cost being born by the ratepayers (exclusively in this case), and this should never be the foregone conclusion.

There are other instances in the conduct of the evidentiary hearing that I feel denied me, as a representative of the ratepayers' interest, access to due process. Specifically, my request for a specific accounting of the actual original costs of the obsolete meters (prorated in light of the fact that they had exceeded 70% of their life expectancy) and an accounting of monies already recovered by DP&L and PHI from ratepayers and through tax depreciation reimbursements was denied by the Hearing Examiner when he sustained the objection of the Public Advocate attorney that I was somehow attempting to introduce new evidence. Inexplicably, I was being limited to accepting the \$25 million unrecovered depreciation costs because that is the number DP&L offered to the Settling Parties as evidence. The obvious concession made without any substantiation of actual monies not recovered, in addition to the fact that I expressed the valid perspective that there is no entitlement of the utility to recover an accounting item identified as lost depreciation when replaced by new, revenue-friendly upgrades, was not allowed to be considered by the Examiner.

At this time I would like to offer the following specific challenges to the Settlement Agreement and disposition of the Docket No. 11-528.

Priority concerns:

Calculation of the "net book value" of the legacy meters is never explained in the evidentiary hearings, the Hearing Examiner's Report, or the Settlement Agreement. This number is the largest figure of the AMI-related regulatory asset. Delmarva puts the undepreciated balance at \$25.5 million for the 311,000 retired meters. That is \$82 per meter. However, out of that \$25.5 million total balance, \$697,776 is for the 11,300 meters installed between 2008 and 2011. That is \$61.75 per meter. How is Delmarva trying to recover \$61.75 for meters installed for a maximum of three years, but \$82 for meters

installed for an average of 22 years? Indeed, how is there \$82 in remaining undepreciated value for meters that are almost three-quarters of the way through their lifespan? These questions are not answered in the record, and I was rebuffed at the Evidentiary Hearing for trying to resolve them.

The Settlement Agreement in no way discusses the savings that Delmarva will realize through the AMI meters. These savings are supposed to be passed through to the customer by offsetting the regulatory asset ("rolled into rates"), according to the Hearing Examiner's Report and Delmarva employee testimony (Tr. 163, 168), but the issue is not addressed in the Settlement. So it is entirely unclear how these savings will be passed through to customers to be realized by them. This means that there will have to be further hearings, at further cost to ratepayers, to resolve this.

Neither the Settlement Agreement nor the Hearing Examiner's Report addresses in any way whatsoever how the \$22 million figure of the Settlement was reached numerically. The only explanation given is that it is "fair." However, this case depends crucially on what the numbers suggest is an accurate return on investment, and not just a balancing of the initial figures given by Delmarva and the Commission, at \$33.2 million and \$15.9 million, respectively.

I think there should be a strong emphasis on how much the Hearing Examiner's Report and the Settlement Agreement are lacking. The focus needs to be on how the Settlement completely lacks any concrete, numerical bases to justify its resultant figures. The Settlement is inherently and factually defective, and should be rejected for that reason.

Other concerns regarding the specifics in the Hearing Examiner's Report:

Delmarva initially requested \$33,186,072, while the Commission recommended \$15,883,075 and the Public Advocate recommended \$17,465,428. This is a huge numerical difference and is not given any analysis or justification in the Hearing Examiner's Report.

The Evidentiary Hearing on August 28, 2012, was the only one to address the proposed Settlement, but the proposed Settlement was released less than two weeks prior, on August 17, giving little time for the public to go through its details. This problem is exacerbated given my treatment as an intervener at the Evidentiary Hearing, which disallowed me from addressing many central concerns.

The capability requirements that must be implemented before Delmarva can obtain the rate increase are ineffective. The amount placed into rates only decreases by the percentage associated with that capability, and the delay is only until the following phase-in date. The monetary punishments are insignificant when compared to the yearly revenue of Delmarva, thus providing no true disincentive. Also, the June 1, 2014, capability largely benefits only Delmarva, as it allows for remote disconnect.

Savings are realized through avoided costs, as per Mr. Ziminsky's testimony (Tr. 170), but these costs have to be passed through to the customers (by being "rolled into rates"), so my question about why the rate needs to be increased to satisfy the \$5 million revenue requirement despite the \$6.4 million in annual savings remains unanswered. Delmarva does not incur the costs, and so these rates would no longer be collected from customers in rates, but this would require them to be passed through to customers. So the costs are passed through with the rate increase, and then the savings have to be passed through? That seems to incur a lot more expense to the ratepayers by incurring additional rate cases. If the AMI-savings that will accrue will be offset against the regulatory asset balance (page 43), then why is this issue not dealt with as those savings accrue, instead of having a Settlement now, and then later having to have to determine how much savings accrued? The Settlement only deals with the revenue increase, and does not mention at all the savings for Delmarva that must be then passed through to the customers. This is especially troubling given that the Public Advocate has testified that "single issue ratemaking is 'a bad idea'" (page 36). If it is important to consider revenue, expenses, and capital items together in determine rates, then it should be important to consider the savings the company will realize as well, since those savings have an equally large impact on determining rates.

Claiming that the parties involved in agreeing to the Settlement "represent diverse interests" is undermined by the fact that the Commission had recommended a lower revenue increase than the Public Advocate at the outset, especially when the Hearing Examiner's Report places so much weight on the support of the Public Advocate (page 37). Also, members of the Commission have spoken out publically against the reasonableness of the figures. In addition, the Hearing Examiner's statement on page 37 (82) that the "Settling Parties represent diverse interests" does not mention that one of those parties is DEUG, which has promoted and agreed to a Settlement that places no financial burden on them.

The Hearing Examiner does not explain in his Report why he believes the Commission would balance each party's positions equally if the case proceeded without the Settlement. The Hearing Examiner also only notes that the Settlement's final figure is "substantially" less than Delmarva's request for \$33,186,072 (page 39), but does not note that it there is a much larger difference between the final figure and the Commission's recommendation of \$15,883,075. Finally, the Hearing Examiner, on page 42, claims Delmarva risks "significant" delay in recovery, despite that delay only being one year out of a fifteen-year period.

Concerns regarding the Settlement Agreement:

How is the "net book value" of the legacy meters calculated? How much has Delmarva recovered for the legacy meters, if the initial cost was \$7.5 million, but depreciation value for last eight years of life is claimed to be \$25.8 million? The meters

have been in service for 22 years out of their 30-year life, so that would mean they are 73% of the way through their life-cycle. The \$25.8 million accelerated depreciation value thus represents the last 27% of their life cycle, which would put the total cost of recovered depreciation at over \$100 million, at least. How much did Delmarva originally pay for the old meters if they are able to recover this amount in depreciation? How was the \$25.8 million figure reached? Was this based on data supplied by Delmarva or was there a wholly independent determination by the Commission and the Public Advocate?

If ratepayers pay for Smart Meters now, then will Delmarva still get depreciation on the meters, even though they fully recovered for the capital cost of the Smart Meters? It would seem that the ratepayers should get the depreciation value if they are the ones ultimately providing the capital for the Smart Meters.

If the rate increase, after all three phase-ins, is to cover the \$5 million annual cost of the Smart Meters, then is the \$6.44 million in savings reflected in the base rate as well? First, the \$6.44 million is "savings that the company is realizing in terms of lower" expenditures. This is stated by Mr. Ziminsky, under oath, testifying on behalf of Delmarva (Tr. 163, lines 9-10). This is not a benefit to the ratepayers unless the company passes through that savings to the ratepayers (Tr. 130, lines 10-11, where Mr. Ziminsky says that the savings would need "to be returned to customers"). Second, how do these savings for the company figure into the base rate? Testimony by Mr. Ziminsky says that "[t]here's still a stream of savings that are not based into base rates" (Tr., lines 12-13). He continues that "[t]hose would revolve credits to the regulatory asset, which would lower the overall number" (Tr. 163, lines 13-15).

A major immediate concern with this is that the Settlement is therefore premature, as it is only covers the costs of implementing the Smart Meters, while leaving the savings for determination at another, later date. Especially in these economic times, how can there be a justification for imposing rate increases to cover capital costs before providing for rate decreases for the savings that have justified the capital expenditures in the first place? A second concern would be how these savings for the company would be passed onto the ratepayer at a later date. The testimony by Mr. Ziminsky states that these savings would "roll into rates" through "avoided cost" by providing for a "lower cost of service each year going forward" (Tr. 140-141). If these savings are going to "roll into rates" at a figure of \$6.44 million per year, then why would there need to be any rate increase to cover the annual cost of \$5 million, when that number for the cost is lower than the number for the savings? Would it not be far wiser to allow for Delmarva to pay for the Smart Meters (at \$5 million annually), and cover that cost through their estimated savings of \$6.44 million annually, and then allow them to request a rate change if the \$6.44 million annual savings turns out to actually be less than the \$5 million annual cost? By accepting the Settlement, the Commission will be permitting a \$5 million annual rate increase, which will then require a later annual credit of \$6.44 million. This results in extra time and money that will be charged to the ratepayer, as there will have to be determinations made later regarding that \$6.44 million annual credit. This completely negates any benefit served by reaching a settlement pursuant to the Public Utilities Act.

Further, the claim that the \$6.44 million will continue (Tr. 129, testimony by Mr. Ziminsky) is deceptive. That \$6.44 figure has been determined based on the 15-year amortization period, although that savings amount will be far greater after those 15 years due to inflation and other costs. This is especially important because the savings are for Delmarva, as stated by Mr. Ziminsky under oath, and Delmarva then has to pass through these savings to the ratepayer as a credit, as also stated by Mr. Ziminsky under oath (Tr. 130, lines 10-11). In response to the question "[W]ill Delmarva continue to give one hundred percent of those savings to customer, or is Delmarva going to keep them?" Mr. Ziminsky responded, "The savings would continue to be *returned* to customers." Will Delmarva be readjusting the savings figure that is "returned" after the 15-year amortization period? Or will Delmarva continue to see larger savings, while the ratepayer continues to realize only the \$6.44 million annual benefit?

How is the \$22 million rate increase figure reached? The Commission originally recommended \$15.8 million, and the Public Advocate recommended \$17.4 million, while Delmarva requested \$33.2 million. How was a figure reached that is so substantially different? Why was Delmarva's initial request over twice the amount originally recommended by the Commission?

Ms. Gannon, representing the Commission, stated that she felt the \$22 million figure "represents a balance of the interest of the parties and that it achieves a compromise between the various positions based on what we had argued and what we believe we could win through further litigation" (Tr. 178). Mr. Sheehy, the Public Advocate, stated that the "\$22 million falls right in that span," with that span being the "fairly narrow range of what a reasonable Commission decision would be" (Tr. 181). How would \$22 million be in the "range of what a reasonable Commission decision would be," if the Commission originally recommended \$15.8 million? Further, how does this \$22 million figure represent a good faith effort on the part of the Public Advocate, who originally recommended \$17.4 million? Mr. Sheehy's sole concrete justification in his testimony on August 28 is that "settlements are in the public interest" (Tr. 183), without providing any explanation as to how that figure of \$22 million was reached, or for why the originally recommended figures by the Commission and Public Advocate were so dramatically lower. The Hearing Examiner's Report, drafted by the Office of the Public Advocate, also similarly fails to identify any specifics as for how the \$22 million figure was reached in the Settlement.

How is the revenue requirement calculated? The first phase-in is 20% of the \$40 million, which is \$8 million. Amortization over 15 years is stated to be a \$1 million a year "revenue requirement" (Tr. 122). Why is \$8 million over 15 years equal to \$1 million instead of \$500,000? Similarly, with the latter two phase-ins, they are 40% of the \$50 million, which is \$16 million, and this is stated to be a "revenue requirement" of \$2 million each annually when amortized over 15 years (Tr. 124-126). Why is \$16 over 15 years equal to a revenue requirement of \$2 million annually instead of \$1 million annually?

Why are GS-T customer class excluded from the increase in distribution rates? These customers use the distribution network, even if not to the same extent as many ratepayers. However, many ratepayers use the distribution network to differing extents. Although a ratepayer may live much farther away from the distribution center, it would never be considered to be fair to charge customers based on the extent of their usage of the distribution network. Why then is an exception made for one class of customers? DEUG's claim that "the class cost of service study appeared to overallocate distribution plant investment to the General Service Transmission class, and so that class should not receive any rate increase" (page 22) is not persuasive, as cost of service should not classify a portion of those costs to the customer function, as this is not fair to other ratepayers, and unjustly benefits one single group because they can argue their difference is easier to discern than differences among other ratepayers.

Further, this exception is made all the more troubling by the fact that DEUG was involved in drafting the Settlement that excludes their group from any increase, and yet their approval of the Settlement is taken as having controlling weight.

Concerns regarding the objectivity of the Hearing Examiner's Report:

The Report states that "the Commission in all likelihood would not likely have decided every contested issue in favor of any one of the participants submitting prefiled testimony; rather, it would more likely have balanced each parties position against certain regulatory principles and reached some compromise between the various positions taken by the parties. In this context, I note that the Settlement's revenue requirement increase is substantially less than the Company's updated request of \$33,186,072" (page 38-39).

This does not note, however, that the \$22 million figure is substantially more than the \$15.8 original recommendation by the Commission. Indeed, the fact that Delmarva's request was so incredibly high suggest that Delmarva was not acting fully in good faith, while on the other hand, the Commission and Public Advocate, who presumably would have far more incentive to act in good faith, as they are not motivated by profit, both recommended substantially lower figures than the resultant \$22 million. Further, the fact that this is "noted" in the Report in this unfair way, without including the figures originally recommended by Commission and the Public Advocate, in the Report drafted by the Public Advocate's Office, should provide serious concern for the interests of the Public Advocate.

The concern for the unfair nature of the Report is further compounded by the fact that the Report, drafted by the Public Advocate's Office, states that "[t]he fact that none of these [previously discussed] alternative regulatory treatments are included in the Settlement is a significant concession by Delmarva, even if that concession cannot be reduced to dollars and cents" (page 39). This is highly deceptive to label this a "significant" concession, and it is entirely inappropriate to rely on this concession as providing any substantive weight for supporting the Settlement, when these requests

should not have been made in the first place by Delmarva. Delmarva had to "concede" these requests because the Commission determined they were improper and without merit.

Continuing in this unfair nature, the Report rejects the objection to including depreciation of the legacy meters, noting that "when the Commission authorized Delmarva to establish a regulatory asset for costs associated with the deployment of AMI, it was aware that the Company was seeking recovery of the undepreciated cost of the legacy meters and the costs of the new AMI meters" (page 40). However, the Report fails to then note that the whole point of the current proceedings was to determine how, and even if, Delmarva would be entitled to recover those costs contained in the regulatory asset. To present the creation of the regulatory asset as supportive of the inclusion of these costs is deceptive, considering that the Commission expressly stated that it would determine the specifics of recovery, including what assets would be recovered, at a later date. Indeed, there have even been changes in the figures associated with that recovery.

The problems regarding the including of the costs of accelerated depreciation is further compounded by the fact that the Report states, "[T]he only issue raised in the proceeding regarding the collection of these costs was the timing of their collection" (page 41). This is not true. There were many other issues, including what costs would be recovered, the requirements for implementation, and possible fines for failures on the part of Delmarva. Clearly, there were other issues aside from timing, or else the proceedings would never have resulted in the final \$22 million recovery figure, which was proposed by no party initially.

It is also unfair to claim that Delmarva will be "subject to financial risk for failure to meet functionality deadlines and conditions" or to claim that the \$125,000 figure "protects Delmarva ratepayers." The \$125,000 fine would represent under 0.02% of the base rate of \$572,556,602. To claim that this represents in any way a "financial risk" to such a company, especially one that would sufficiently "protect ratepayers," is without merit.

The fact that the Hearing Examiner's Report notes, in support of the Settlement, that "significant weight [is placed] on the Public Advocate's support of a settlement as being in the public interest since that entity is charged with protecting Delaware's ratepayers" (page 38, footnote 12), should be highly troubling given the unfair nature of the Report, which was in fact drafted by the Public Advocate's Office. If the Public Advocate is willing to present an unfair understanding of the issues in drafting the Report, then little weight should be given to the support for the Settlement by the Public Advocate, regardless of the stated duty placed on the Public Advocate by the enabling statute. Indeed, it provides more credence to the currently proposed review of the Public Advocate's Office by the Sunset Committee. This is especially so, given that the figures recommended by the Public Advocate—a body expressly charged with protecting the public—were at all times more favorable to Delmarva than the Commission's figures—a body which is not given that express mandate. Given the attitude of the Public Advocate,

it is not surprising that it was this group that was the one group to disparage my efforts in acting as an intervener.

Final concerns:

The \$6.44 million in savings is not included in the Settlement. From the testimony of the August 28 Hearing, it seems that these savings go to the company, and then have to be "rolled into rates" to consumers (the testimony also references the need for the savings to be "returned to the customer"). When will this "rolling" or "return" occur, how will it occur, and who will determine how much should be "returned" or "rolled into rates"? Also, how will this "return" work after the 15-year amortization period, as the testimony stated these savings will continue to be "returned" to the customer?

Finally, regarding the Hearing Examiner's Report, I think any decision based on it should emphasize the fact that the Report provides virtually no concrete justification for support of the Settlement, outside the fact that the parties to the Settlement all support it (which is of course little justification if there are alleged deficiencies in those parties, especially those charged with representing the public interest). The Report provides no details or analyses of how the monetary figures are reached, or why they are fair (which reflects the same deficiencies in the testimonies at the August 28 Evidentiary Hearing). Of course, this relates to one of my main concerns, regarding how the value of the accelerated depreciation of the legacy meters is calculated. It also addresses another of my main concerns, regarding how the value of the savings has been and is going to be determined and then implemented. Neither the Public Advocate nor the Commission provided any reasons for why their initial recommended figures of \$17.4 million and \$15.8 million, respectively, were disregarded in favor of the Settlement figure of \$22 million, a substantially higher amount.

Respectfully,

John A. Kowalko Jr. State Representative 25th District **Intervener PSC DOCKET NO. 11-528**